# SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1939.

Nos. 130 - 131

WILLARD MANUFACTURING COMPANY,
Petitioner,

v.

J. E. KENNEDY, Former Collector,

and

WILLARD MANUFACTURING COMPANY,
Petitioner,

v.

ROBERT W. McCUEN, Collector.

PETITION FOR WRITS OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

## PETITION FOR WRITS OF CERTIORARI
AND
## BRIEF IN SUPPORT OF THE PETITION.

O. WALKER TAYLOR,
11 Beacon Street, Boston, Massachusetts,
*Attorney for Petitioner.*

L. H. LANE COMPANY, Law Printers, 221 High Street, Boston.

# INDEX.



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*v.*

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## PETITION FOR WRITS OF CERTIORARI

TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*To the Honorable, the Chief Justice and the Associate Justices, of the Supreme Court of the United States:*

Your petitioner, the Willard Manufacturing Company of St. Albans, Vermont, earnestly prays this Honorable Court for writs of certiorari to the United States Circuit Court of Appeals for the Second Circuit for a review of the judgments of that Court, in the above-entitled causes, which affirmed the judgments rendered against your petitioner, the plaintiff below, by the United States District Court for the District of Vermont.

## OPINIONS BELOW.

The opinion of the District Court, which is unreported, consists of a "Decision of the Facts" (R. p. 28), a "Memorandum of Opinion on the Law" (R. p. 31), a "Judgment Order" (R. p. 33) and a "Decision *in re* Defendant's Exceptions" (R. p. 33), all of which were filed on September 16, 1938.

The opinion of the Circuit Court of Appeals (R. p. 229) was rendered on January 22, 1940, and is reported in 109 F. (2), 83.

## JURISDICTION.

The cases arose under the Internal Revenue Laws and the jurisdiction of this Honorable Court is invoked under the Act of February 13, 1925, c. 229, Section 1; 43 Stat. 938; U. S. Code, Title 28, Section 347.

By an order dated April 18, 1940, and signed by Mr. Justice Stone, the time to file petition for certiorari was extended for a period of sixty days from April 22, 1940 and this petition, together with the record, was filed within that period.

## THE STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved, the pertinent parts of which are set forth in the appendix, are as follows:

1. *Revenue Act of* 1918 (40 *Stat.* 1057–1060).
   (1) *Section* 203.
2. *Regulations* 45 (1920 *Edition*).
   (1) *Article* 1582.
   (2) *Article* 1584.

## STATEMENT OF THE CASE.

The suits were brought simultaneously, the one against J. E. Kennedy, as former collector, and the other, against his successor, Robert W. McCuen, who was still in office, as Collector of Internal Revenue for the District of Vermont, on August 28, 1929 when the writs were issued (R. pp. 3, 7).

The taxes involved are the Federal income and profit taxes for the petitioner's fiscal or "taxable year" ending August 31, 1920. The total amount sued for is $12,116.76 of which $9,793.71 was paid to the defendant Kennedy in installments during 1921 and $2,323.05 was paid to the defendant McCuen on September 8, 1926 (R. p. 39).

Since only one taxable year is involved, the two cases were consolidated and heard together by the District Court, sitting without a jury, on September 14, 15 and 16, 1932 and were decided together by that Court six years later on September 16, 1938.

The whole controversy revolves around the valuation which the Commissioner of Internal Revenue put upon the petitioner's inventory of cotton goods in making his final determination of the petitioner's tax liability for its taxable year ending August 31, 1920. The two specific questions as presented to the Circuit Court of Appeals are as follows:

## THE QUESTIONS INVOLVED.

FIRST: *Was the Appellant authorized or permitted under the applicable statutes and regulations to report its inventory of cotton goods, as of August 31, 1920, on the basis of "cost or market, whichever is lower"?*

SECOND: *Was the value of the appellant's cotton goods inventory as of August 31, 1920, when taken on the basis of "cost of market, whichever is lower", $167,609.69 as determined by the Commissioner of Internal Revenue and sus-*

*tained by the judgment of the District Court, or,* $135,-209.16 *as claimed by the appellant?*

The District Court made a special finding and ruling sustaining the plaintiff, petitioner herein, with respect to the first question (R. p. 33) but decided the cases against the plaintiff on the second question (R. pp. 28, 31).

The Circuit Court of Appeals found and ruled against the appellant, the petitioner, herein, on both of the questions, but:

1. As to the first question the opinion of the Circuit Court of Appeals (R. pp. 232–233) states:

> "But even if we were in error in this conclusion the appellant could not prevail unless we should overrule the Court's findings as to market conditions existing at August 31, 1920."

2. As to the second question the opinion of the Circuit Court of Appeals (R. p. 234) states:

> "Therefore, the Court's findings must be sustained, even though the case was so close that had there been a finding to the contrary of the one made, we might have been unwilling to upset it."

While the cases may not seem to present any questions of fact or of law (1) which are entirely new in their nature or (2) which appear to be of great public interest and concern, we nevertheless earnestly believe, and, therefore, respectfully submit to this Honorable Court that there are special, important and just reasons why this petition for certiorari should be granted, among which are the following:

**GROUNDS FOR THE ALLOWANCE OF THE PETITIONS FOR CERTIORARI.**

1. The opinion of the Circuit Court of Appeals clearly reveals that the Court itself felt grave doubts as to the correctness of its own conclusions with respect to both questions, thus so far departing from the accepted and usual course of appellate proceedings as to call for the exercise of this Court's power of supervision.

2. The Circuit Court of Appeals erred in overruling the District Court on the first question because the findings and rulings of the District Court on that question are clearly sustained by the evidence adduced at the trial and by the Commissioner's regulations promulgated under the statute pertaining to the valuation of inventories.

3. The Circuit Court of Appeals erred in its interpretation of *Article* 1582 *of Regulations* 45, as applied to the facts and circumstances of the instant cases, since that Court seems to have attached greater weight to mere form than to the real substance and purpose of the regulation.

4. Both the District Court and the Circuit Court of Appeals erred in their findings of fact with respect to market conditions existing at August 31, 1920, which is the gist of the second question, since (1) neither of the decisions is supported by any substantial evidence and (2) both of them are directly in conflict with decisions of the Court of Claims and the Board of Tax Appeals with respect to market conditions as they existed on that date.

5. The Circuit Court of Appeals erred in that its decision on the second question seems to rest solely on the case of *Elder Manufacturing Company* v. *United States,* 10 Fed. Supp. 125, but that case is clearly not in point because the inventory date in that case was April 30, 1920 when the cotton trade was booming and cotton prices were high, while in the cases at bar the inventory date is August 31,

1920 when there had occurred a great drop in the prices of cotton goods and an almost complete collapse in the cotton trade in general.

## CONCLUSION.

WHEREFORE it is earnestly prayed that this petition may be granted to the end that the judgment of the Circuit Court of Appeals for the Second Circuit may be reviewed by this Honorable Court and that your petitioner may have such other and further relief as the ends of justice may require.

Respectfully submitted,

O. WALKER TAYLOR,
*Attorney for Petitioner.*

## BRIEF IN SUPPORT OF THE PETITION.

### PRELIMINARY STATEMENT.

All of the detailed facts with respect to the petitioner, the nature of its business, the filing of the returns and the claim for refund are fully set forth in the record (R. pp. 13–16) and it seems unnecessary to set them out herein.

As to the record itself, we beg to explain that we think that it is entirely too voluminous. This was brought about by the insistence of counsel for the Government, as appellee below, that the testimony of all of the witnesses be printed in question and answer form. In the event of the granting of the petition for certiorari, it is hoped that the record may be greatly diminished.

### ARGUMENT.

As to the five reasons stated as grounds for the allowance of the petition for certiorari the following comments, arguments and authorities are respectfully submitted:

#### THE FIRST GROUND.

It is obvious from the opinion of the District Court as well as that of the Circuit Court of Appeals that the plaintiff, the petitioner herein has an honest and meritorious case and that both of the Courts below entertained grave doubts as to the correctness of their decisions. This is clearly established by the fact (1) that the District Court delayed its decision for six years after the trial and (2) that the Circuit Court of Appeals clearly expressed its doubts in its own opinion.

It is well established that all doubts in cases involving taxes should be construed strictly against the Government and in favor of the taxpayer.

*Gould* v. *Gould,* 245 U.S. 151; 38 S. Ct. 53.
*United States* v. *Merriam,* 263 U.S. 179; 44 S. Ct. 69.
*Shwab* v. *Doyle,* 258 U.S. 529; 42 S. Ct. 391.

The rule with respect to such doubts was clearly stated by Mr. Justice McKenna in the case of *Shwab* v. *Doyle, supra,* where he said:

> "But, granting the contention of the defendant has plausibility, it is to be remembered that we are dealing with a tax measure, and whatever doubts exist must be resolved against it."

In this respect we think it is clear that the decisions of the Courts below are directly in conflict with the decisions of this Honorable Court.

**THE SECOND GROUND.**

It is clear that the Circuit Court of Appeals erred in holding that the plaintiff's inventory was not properly made on the basis of cost or market whichever is lower and in overruling the decision of the District Court on that question (1) because there is no evidence to support such a finding by that Court and also (2) because the regulations of the Commissioner of Internal Revenue permitted the adoption of the basis of cost or market in 1920 regardless of the past practice of taxpayers.

The District Court found and ruled (R. p. 33) as follows:

> "The decision is that the plaintiff inventoried its merchandise August 31, 1920, 'at cost or market, whichever was lower', . . . as it had done in prior years."

We respectfully submit that this decision of the District Court is strongly supported by the evidence and clearly sustained by the regulation and the authorities. As to the evidence (1) an officer of the Willard Manufacturing Company

(R. p. 43, (2) a certified public accountant (R. p. 79) and (3) the Revenue Agent who examined the petitioner's 1920 return and the claim for refund upon which these suits are based (R. p. 60) all testified that the plaintiff's inventory was in fact taken on the basis of cost or market whichever is lower. The report of the Revenue Agent (R. p. 61) states as follows:

> "A complete Revenue Agents Report was submitted under date of May 21, 1925, covering the years ended August 31, 1920 and 1921. The claim referred to above covers the fiscal year ended August 31, 1920, and contends that the closing inventory for this year should be reduced in the amount of $31,060.44 because of a reduction in price during September of 1920.
>
> *"It appears from a thorough investigation of the prices used by this taxpayer in the original closing inventory that the basis used of cost or market, whichever was lower, was correct."* (Italics supplied.)

It is true as stated in the opinion of the Circuit Court that in its 1920 return, the word cost was written in the space provided for a statement of the basis on which the return was filed. But, the testimony of the witnesses above referred to and the other documentary evidence clearly showed that the word cost was written on the return by the President of the Company who had not actually made up the inventory. Moreover, the plaintiff clearly showed to the District Court by the witnesses and by the items themselves that it was the practice of the company to use the "cost or market, whichever is lower" basis. Many of the items are shown on the return below "cost". The total value of the inventory as shown on the return is $167,609.69 but the evidence (Plaintiff's Exhibit 13) shows that the total cost was $173,-174.51. If, as the Circuit Court of Appeals holds, the inventory was actually made on the basis of "cost", the Com-

missioner of Internal Revenue would then have determined the value to be $173,174.51.

It is thus apparent that the petitioner never changed the basis of reporting its inventory. Even if it had it would have been entitled to do so for the year 1920 under the special provisions of *Article* 1582 *of Regulations* 45 (p. 24, *infra*) which specifically provides that "a taxpayer may, regardless of its past practice, adopt the basis of cost or market, whichever is lower for its 1920 inventory".

In the case of *Howard Company* v. *Commissioner of Internal Revenue,* 15 B. T. A. 1096, in which the Commissioner acquiesced, the taxpayer had actually made its inventory for a fiscal year ending in 1920 on the basis of "cost" and had so stated in its return for that year. After *Article* 1582 *of Regulations* 45 was amended as above indicated, that company changed the basis and reported its inventory on the basis of "cost or market, whichever is lower". The Commissioner of Internal Revenue held that the company was precluded from changing because it had not so indicated on its original return. An appeal was taken to the United States Board of Tax Appeals and in the course of the opinion the Board said:

> "As we understood the situation, there is no controversy save as to the timeliness of the adoption by the petitioner of the 'cost or market, whichever is lower' basis. That is, the Commissioner does not question that the regulation in question would be applicable to a fiscal year taxpayer, situated as the petitioner, where a drop in market prices had occurred prior to the close of its fiscal year ending in 1920, as well as to one on a calendar year basis for 1920, nor is it questioned that had the change been timely made, income would have been properly determined by using the inventories as submitted by the petitioner on the 'cost or market,

whichever is lower' basis. Our only question then is whether the petitioner is to be denied the right to adopt a new basis for pricing its inventories because it was late in seeking to make the change.

. . . .

"There can be little question that this petitioner is not foreclosed from the benefit of the foregoing provision because it did not make the change on its return when filed for the reason that the Treasury Decision which amended an existing regulation and gave authority for the change *was not promulgated until several months after the return was filed.*" (Italics supplied.)

In the cases at bar the Commissioner of Internal Revenue never raised any question (1) as to the petitioner's right to report its inventory on the basis of cost or market, whichever is lower, or (2) as to the fact that the inventory was intended to be so reported in 1920 as well as in other years, although he made the usual examination of the return and fully considered and rejected the claim for refund on entirely different grounds. The question was first raised by counsel for the government when the case came on for trial in the District Court.

In the case of *Peck & Hills Furniture Company* v. *Commissioner of Internal Revenue,* 16 B. T. A. 1008 in which the Commissioner also acquiesced, the taxpayer kept its books of account on the fiscal basis and its taxable year ended June 30, 1920 and actually reported its inventory on the basis of "cost" on its 1920 return. The Board held that regardless of that fact and the past practice, that company was entitled to have its inventory valued on the basis of "cost or market, whichever is lower".

The truth of the matter is that this regulation permitting taxpayers to adopt the cost or market basis for its taxable year 1920 was not promulgated until after the petitioner's

return for its taxable year 1920 had already been filed. In the very nature of things, therefore, it could not be expected to state on its return that its inventory was reported on that basis, and yet, in its opinion the Circuit Court of Appeals said:

> "In its 1920 return the appellant stated that its inventory was based on 'cost'. . . . There is no evidence that it ever obtained permission from the Commissioner to change the basis of its 1920 return; or that it ever attempted to change until it filed its claim for refund in December, 1926. . . ."

**THE THIRD GROUND.**

It is clear from the evidence, from the cases cited above and from many other similar cases which might be cited, that the Circuit Court of Appeals erred in its interpretation of *Article* 1582 *of Regulations* 45 as applied to the facts and circumstances of the instant cases in that it attached greater weight to "mere form" than to the real substance of the matter and entirely disregarded the fact that *Article* 1582 *of Regulation* 45 is in its nature "relief legislation" which should be construed most liberally in favor of the taxpayer.

*Treasury Decision* 3108 which was later embodied in *Regulations* 45 as *Article* 1582 which permitted a taxpayer to adopt the basis of "cost or market whichever is lower" for his 1920 inventory was not promulgated until after the Willard Manufacturing Company had filed its 1920 return. Regardless of this fact, the Circuit Court of Appeals held that the taxpayer should not be allowed to adopt that basis merely because it did not so state on the return. It was never necessary for the petitioner to get permission of the Commissioner to change the basis of reporting its inventory because both the Revenue Agent and the District Court found as a fact that the inventory had always been reported

on the basis of "cost or market whichever is lower". In this respect we think the Circuit Court of Appeals not only misconceived the purpose and intent of the regulation but construed this relief provision strictly against the taxpayer.

In the case of *Tucker* v. *Alexander,* 275 U.S. 228; 48 S. Ct. 45, Mr. Justice Stone said:

> "The statute and the regulations must be read in the light of their purpose. They are devised, not as traps for the unwary, but for the convenience of government officials in passing upon claims for refund and in preparing for trial. Failure to observe them does not necessarily preclude recovery. If compliance is insisted upon, dismissal of the suit may be followed by a new claim for refund and another suit within the period of limitations. If the Commissioner is not deceived or misled by the failure to describe accurately the claim, as obviously he was not here, it may be more convenient for the government and decidedly in the interest of an orderly administrative procedure that the claim should be disposed of upon its merits on a first trial without imposing upon government and taxpayer the necessity of further legal proceedings. . . ."

**THE FOURTH GROUND.**

The fourth ground or reason for the allowance of the petition for certiorari is that both the District Court and the Circuit Court of Appeals erred in their findings of fact with respect to the market conditions existing in the cotton industry on August 31, 1920. The findings of the District Court in this respect as made on September 16, 1938 are directly in conflict with the findings which the Court made during the progress of the trial on September 15, 1932.

In its "Decision of the Facts" (R. p. 30) the District Court found as follows:

"On August 31st, the prices instead of being nominal were real and actual. . . . Still there was an 'open market' for such cloths in substantial volume and the quotations were not 'nominal due to stagnant market conditions', for divers small quantities were traded in daily at 'current bid prices' in the volume usually 'purchased by this taxpayer'. The market was merely inactive instead of active for purchasers were expecting materially lower prices."

As contrasted with the foregoing findings, the District Court during the course of the trial while the evidence was being offered and all of the witnesses were present, found, ruled or commented as follows:

"There has been a big drop in regard to the market. The market for finished goods was abnormal. They were trying to hold the prices up. . . . The market price was the price at which a willing purchaser was willing to buy, and a willing seller willing to sell. There were not many willing purchasers on August 31st, and the man says he lost his trade and could not do any business. Then the market would not be normal. Then they hold the prices up a long while, to October 1st or October 15th, but the market would not be there. That would be a fictitious market because the drop had occurred. There is no way that can be gotten away from, no matter how many witnesses testify. That is the law of supply and demand, and it has held good through all the ages. Prior to this time (August 31, 1920) there has been evidence to show the drop, and you have a big job on your hands to convince me that there was a normal market for these goods without reducing prices. You have an awful job on your hands if you expect to do that. It certainly is not a question of what ought to be the market. What

was the true condition of the market on August 31st has to be found out and taken into consideration including all the factors one of which is the crop . . . He may have carried on, hoping against hope that it would come up again. That he did not mark down his price until September is not the true test of what the market value was on August 31st."

The Circuit Court of Appeals seems entirely to have disregarded these earlier findings of the District Court on this point, for as pointed out above, it does state that "the case was so close that had there been a finding to the contrary of the one made, we might have been unwilling to upset it".

We respectfully submit to this Honorable Court that there was abundant evidence adduced at the trial to support "a finding to the contrary of the one made" by the District Court, and that neither of the decisions of the lower Courts is supported by any substantial evidence.

*Mr. Lester T. Redman,* of Lawrence and Company, a witness for the plaintiff, whose qualifications as an expert on market values of cotton goods was not and cannot be impeached, testified in substance (R. pp. 95, 96) as follows:

> "In view of the condition with a falling market and a price list which was reduced on September 30th from the May list by 10 cents, and August 31st coming only a month prior to the new price list, I should say that the price list of September 30th more nearly represented the value of the goods than the price list of May 13th, . . . From June, 1920, until June of the following year, there was a very drastic drop. This whole period of the duration of the war was what I would call an abnormal market. One of the cloths in question, which is on the inventory and which was priced in May, 1920 at 43½ cents . . . went down from 43½ to 17½ cents,

and such fluctuation in that class of goods is something that is entirely unknown in the trade," . . .

*Mr. Lacy H. Sellers,* the Secretary of the Cone Export and Commissions Company of Greensboro, North Carolina, a witness for the Government, in his deposition (R. p. 183) testified in substance in regard to the leading cotton fabric dealt in by his company as follows:

> "That his firm named a price in June, 1920 of forty-four cents on number 26-220 for August, September and October shipment and on that basis the production of the mills had to be allotted. The question of when the break came in regard to the fabric denim, representing a large part of his business, is rather difficult to answer because after the offering of June 21, 1920 and after selling up the mills production at that price covering the shipments to be made up through October, they withdrew from the market. Beginning along in the early fall months of that year these orders commenced to look undesirable to the purchasers and the market commenced to weaken from that point and as he recalls the next price they named when they offered the denim again for sale was on the basis of 25 cents. The decline in the market commenced to be more pronounced along in August or early in September."

*Mr. Robert D. Vanderbilt,* a witness for the Government, in his deposition (R. pp. 209–211) testified substantially as follows:

> "Our records were such that on the date of August 31st there was nothing to indicate the existence of a definite market value for the goods. That was a period of marked fluctuation in values and, to protect the interest of our mills, our goods were held for some time without a price.

"Whether or not there were actual sales made on or around that date, we have no records to disclose. Our records, upon examination, did indicate that goods were billed at or around this date. They were billed at varying prices. That, coupled with my recollection of the conduct of our business during that period, makes me feel certain that we resorted at that time to what is called 'at value' selling.

"It varied with different goods, but generally speaking most of our goods throughout the entire house were put 'at value' about the middle of August, 1920."

All of the foregoing evidence as to market conditions as given by the experts, is directly in line with a mass of documentary evidence which was offered at the trial.

*The Year Book of the National Association of Cotton Manufacturers* (Plaintiff's Exhibit No. 12, pp. 7 and 8) describes the abnormal conditions prevailing in the cotton cloth market during the middle and latter part of 1920 in the following language:

"Were it possible for cotton merchants to look back upon their experiences during the year 1920 quite dispassionately and disinterestedly, it is safe to say that they would find them dramatic to an extent scarcely paralleled in all commercial history. In particular, the contrast presented by the conditions existing in the cotton trade in the early part of the year, as against those with which merchants had to contend as the year drew towards its close, is one of the most violent of which we have any record.

. . . .

"From the point of view of those actually engaged in the cotton business, however, the decline of nearly 70 per cent. in the general price of the commodity which